

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
UNFUNDED PENSION COSTS OF
BLUE CROSS AND BLUE SHIELD
OF MISSISSIPPI**



JUNE GIBBS BROWN
Inspector General

SEPTEMBER 1997
CIN: A-07-97-01210



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

CIN: A-07-97-01210
September 8, 1997

Mr. John Proctor, III, JD, CFE
Director, Corporate Audit
Blue Cross Blue Shield of Mississippi
P.O. Box 1043
Jackson, Mississippi 39215-1043

Dear Mr. Proctor:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Unfunded Pension Costs of Blue Cross Blue Shield of Mississippi*. The purpose of our review was to determine if pension costs for Plan Years 1986 through 1995 were funded in accordance with the Federal Acquisition Regulations (FAR).

Blue Cross Blue Shield of Mississippi (Mississippi) did not make contributions to the pension trust fund for Plan Years 1987 through 1991. Accordingly, Mississippi did not fund the pension costs identifiable with its Medicare segment during this period. As a result, Mississippi accumulated unfunded pension costs of \$482,549 as of January 1, 1996. Mississippi must separately identify and eliminate this amount from the amortization components of future pension costs.

Mississippi accepted our recommendation and its response is included in its entirety as Appendix B.

INTRODUCTION

BACKGROUND

Cost Accounting Standards (CAS) and FAR

For Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413, and (2) funded as specified by part 31 of the FAR. The CAS deals with stability between contract periods and requires that pension costs be consistently measured and assigned to contract periods. The FAR addresses the allowability of

pension costs and requires that pension costs assigned to contract periods be substantiated by funding.

The CAS within 48 Code of Federal Regulations (CFR) 9904.412-50(a)(7) states:

If any portion of the pension costs computed for a cost accounting period is not funded in that period, no amount for interest on the portion not funded in that period shall be a component of pension cost of any future cost accounting period.

In addition, the CAS within 48 CFR 9904.412-50(a)(2) states:

Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions shall be separately identified and eliminated from any unfunded actuarial liability being amortized....

Furthermore, the FAR, 48 CFR 31.205-6(j)(3)(i) and (iii), states:

...costs of pension plans not funded in the year incurred, and all other components of pension costs...assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years....

Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

Employees Retirement Income Security Act of 1974 (ERISA)

The FAR funding requirement has traditionally been satisfied by trust fund deposits qualifying for tax-exemptions under ERISA. The ERISA provided for a minimum and a maximum deposit to pension funds as determined each year. The minimum represented a required deposit while the maximum represented the upper limit that could be deducted for income tax purposes for the year for which the deposit was applicable.

Pension costs computed in accordance with CAS represented an assignment of pension costs to specific accounting periods. The CAS pension costs often fell between ERISA minimum and maximum contributions. If contractors deposited the minimum ERISA contribution in their qualified trust funds, and the CAS pension costs exceeded the ERISA minimum, the contractors could only claim the funded portion of the CAS amount as allowable contract costs. Additionally, the excess of the CAS costs over the ERISA minimum contribution could not be carried forward as a component of future CAS pension costs.

Conversely, if CAS pension costs before 1986 were greater than maximum ERISA contributions, contractors could deposit the CAS amounts in qualified trust funds, claim them

as allowable contract costs, and take ERISA maximums as tax deductions. The excess of the CAS amount over the ERISA maximum could be carried forward to future years for tax deductibility. Similarly, if contractors deposited ERISA maximums that were larger than CAS computed amounts, differences could be carried forward to fund allowable contract costs for future years.

Tax Reform Act of 1986 (TRA 86)

The TRA 86 changed the effect of making pension plan contributions in excess of ERISA maximums. The ERISA maximum was still the tax deductible limit and the excess could still be carried forward to future years for deductibility. However, TRA 86 imposed an excise tax of 10 percent on contributions in excess of ERISA maximums. The excise tax is cumulative from year to year and applied on a first-in/first-out basis considering carry-forwards and current year contributions.

Omnibus Budget Reconciliation Act of 1987 (OBRA 87)

Prior to OBRA 87, ERISA's full funding limitation traditionally considered accumulated assets and the actuarial liability. If assets equalled or exceeded the actuarial liability, the tax deductible amount was limited to zero. With OBRA 87, the Congress took additional action affecting contractors' pension plan contributions to qualified trust funds.

The OBRA 87 imposes a second more restrictive test to the full funding limitation. It considers the accumulated assets and 150 percent of the amount designated "current liability." The actuarial liability under the pre-OBRA 87 test was based on projected benefits and conservative valuation assumptions. The current liability test of OBRA 87 considers only currently accrued benefits and values the liability using interest rates based on Treasury rates. The effect was that most pension plans that were already in full funding would remain there longer. Also, the same effect would push additional plans into full funding.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to identify any unfunded CAS costs, plus appreciation on the unfunded costs, from April 1, 1986 to January 1, 1996. Achieving our objective did not require that we review the internal control structure of Mississippi.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-97-01209) and pension costs claimed for Medicare reimbursement (CIN: A-07-97-01211). The information obtained and reviewed during those audits was also used in performing this review.

The Health Care Financing Administration (HCFA) Office of the Actuary developed the methodology used for computing the CAS pension costs based on Mississippi's historical practices.

We performed site work at Mississippi's corporate offices in Jackson, Mississippi during February 1997. Subsequently, we performed audit work in our Jefferson City, Missouri Office.

FINDING AND RECOMMENDATIONS

As of January 1, 1996, Mississippi had accumulated \$482,549 in previously unallowable direct pension costs related to its Medicare segment. These costs represent unfunded pension costs and imputed interest for Plan Years 1986 through 1995.

Mississippi did not make contributions to the pension trust fund in Plan Years 1987 through 1991 because the pension plan was fully funded. Mississippi's actuary recommended in the actuarial valuation reports for those years that the plan not be funded.

The CAS pension costs not funded are unallowable as a component of pension costs for any future years. Imputed interest on the unfunded costs is also unallowable. In addition, the unfunded costs cannot be claimed in future cost accounting periods.

We compared CAS pension costs for the Medicare segment, computed by HCFA Office of the Actuary, to actual contributions to the Medicare segment. We found that the Medicare segment had accumulated unfunded pension costs, plus interest, of \$482,549 for plan years 1986 through 1995. The following table shows the unfunded amounts, and interest on a cumulative basis.

Unfunded CAS Pension Costs and Interest

<u>Year</u>	<u>Unfunded CAS Costs</u>	<u>Interest To 1/1/96</u>	<u>Total As Of 1/1/96</u>
1986	\$ 59,761	\$ 58,032	\$117,793
1987	24,019	19,818	43,837
1988	30,051	20,730	50,781
1989	12,727	7,188	19,915
1990	13,840	6,212	20,052
1991	171,581	58,590	230,171
1992	0	0	0
1993	0	0	0
1994	0	0	0
1995	0	0	0
Total	<u>\$311,979</u>	<u>\$170,570</u>	<u>\$482,549</u>

Our computation of the unfunded amounts plus interest considers those costs which should have been funded for the applicable years. In other words, if Mississippi funded the costs, the assets of the Medicare segment would have been greater. Appendix A provides additional information on the CAS pension costs.

Recommendations

We recommend that Mississippi:

- Identify \$482,549 as an unallowable component of direct pension costs as of January 1, 1996.

Auditee Response

Mississippi accepted our recommendation.

OTHER MATTERS

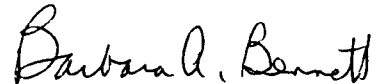
The Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs effective March 30, 1995. The revised CAS removes the regulatory conflict between the funding limits of ERISA and the period assignment provisions of the CAS. Additionally, the new rule will allow the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. However, the method or methods used to reassign the unfunded pension costs must be approved by the contracting officer.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS actions official identified on the following page. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5).

Sincerely,

A handwritten signature in cursive script that reads "Barbara A. Bennett".

Barbara A. Bennett
Regional Inspector General
for Audit Services, Region VII

Enclosures

BLUE CROSS BLUE SHIELD OF MISSISSIPPI

CIN: A-07-97-01210

STATEMENT OF CAS PENSION COSTS AND FUNDING
APRIL 1, 1986 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare Segment
04/01/86 Normal Cost	<u>1/</u>	\$530,732	\$471,261	\$59,471
04/01/86 Amortization Payment	<u>2/</u>	(89,277)	(88,961)	(316)
04/01/86 CAS Pension Cost	<u>3/</u>	441,455	382,300	59,155
Interest to 03/31/87	<u>4/</u>	35,316	30,584	4,732
03/31/87 CAS Funding Target	<u>5/</u>	476,771	412,884	63,887
Contribution	<u>6/</u>	(29,390)	(25,452)	(3,938)
Interest to 03/31/87	<u>7/</u>	(1,404)	(1,216)	(188)
03/31/87 Unfunded Pension Cost	8/	\$445,977	\$386,216	\$59,761
04/01/87 Normal Cost		\$435,540	\$388,736	\$46,804
04/01/87 Amortization Payment		(261,249)	(236,685)	(24,564)
04/01/87 CAS Pension Cost		174,291	152,051	22,240
Interest to 03/31/88		13,943	12,164	1,779
03/31/88 CAS Funding Target		188,234	164,215	24,019
Contribution		0	0	0
Interest to 03/31/88		0	0	0
03/31/88 Unfunded Pension Cost		\$188,234	\$164,215	\$24,019
04/01/88 Normal Cost		\$481,450	\$429,965	\$51,485
04/01/88 Amortization Payment		(299,358)	(275,698)	(23,660)
04/01/88 CAS Pension Cost		182,092	154,267	27,825
Interest to 03/31/89		14,567	12,341	2,226
03/31/89 CAS Funding Target		196,659	166,608	30,051
Contribution		0	0	0
Interest to 03/31/89		0	0	0
03/31/89 Unfunded Pension Cost		\$196,659	\$166,608	\$30,051

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Description	Total Company	Other Segment	Medicare Segment
04/01/89 Normal Cost	\$447,125	\$397,707	\$49,418
04/01/89 Amortization Payment	(298,075)	(260,441)	(37,634)
04/01/89 CAS Pension Cost	149,050	137,266	11,784
Interest to 03/31/90	11,924	10,981	943
03/31/90 CAS Funding Target	160,974	148,247	12,727
Contribution	0	0	0
Interest to 03/31/90	0	0	0
03/31/90 Unfunded Pension Cost	\$160,974	\$148,247	\$12,727
04/01/90 Normal Cost	\$533,767	\$485,170	\$48,597
04/01/90 Amortization Payment	(182,305)	(146,523)	(35,782)
04/01/90 CAS Pension Cost	351,462	338,647	12,815
Interest to 03/31/91	28,117	27,092	1,025
03/31/91 CAS Funding Target	379,579	365,739	13,840
Contribution	0	0	0
Interest to 03/31/91	0	0	0
03/31/91 Unfunded Pension Cost	\$379,579	\$365,739	\$13,840
04/01/91 Normal Cost	\$690,075	\$597,341	\$92,734
04/01/91 Amortization Payment	66,911	774	66,137
04/01/91 CAS Pension Cost	756,986	598,115	158,871
Interest to 03/31/92	60,559	47,849	12,710
03/31/92 CAS Funding Target	817,545	645,964	171,581
Contribution	0	0	0
Interest to 03/31/92	0	0	0
03/31/92 Unfunded Pension Cost	\$817,545	\$645,964	\$171,581

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STATEMENT OF CAS PENSION COSTS AND FUNDING

APRIL 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
04/01/92 Normal Cost	\$721,132	\$614,891	\$106,241
04/01/92 Amortization Payment	95,359	19,618	75,741
04/01/92 CAS Pension Cost	816,491	634,509	181,982
Interest to 03/31/93	65,319	50,760	14,559
03/31/93 CAS Funding Target	881,810	685,269	196,541
Contribution	(895,779)	(703,166)	(192,613)
Interest to 03/31/93	(18,267)	(14,339)	(3,928)
03/31/93 Unfunded Pension Cost	\$(32,236)	\$(32,236)	\$0
04/01/93 Normal Cost	\$673,988	\$563,596	\$110,392
04/01/93 Amortization Payment	329,390	205,184	124,206
04/01/93 CAS Pension Cost	1,003,378	768,780	234,598
04/01/93 Prepayment Credit 9/	(32,235)	(24,698)	(7,537)
Interest to 12/31/93	58,269	44,646	13,623
12/31/93 CAS Funding Target	1,029,412	788,728	240,684
Contribution	(1,907,050)	(1,668,255)	(238,795)
Interest to 12/31/93	(15,089)	(13,200)	(1,889)
12/31/93 Unfunded Pension Cost	\$(892,727)	\$(892,727)	\$0
01/01/94 Normal Cost	\$981,349	\$817,148	\$164,201
01/01/94 Amortization Payment	493,516	316,651	176,865
01/01/94 CAS Pension Cost	1,474,865	1,133,799	341,066
01/01/94 Prepayment Credit	(892,727)	(686,282)	(206,445)
Interest to 12/31/94	46,571	35,802	10,769
12/31/94 CAS Funding Target	628,709	483,319	145,390
Contribution	(1,524,081)	(1,380,544)	(143,537)
Interest to 12/31/94	(19,679)	(17,826)	(1,853)
12/31/94 Unfunded Pension Cost	\$(915,051)	\$(915,051)	\$0

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STATEMENT OF CAS PENSION COSTS AND FUNDING
APRIL 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
01/01/95 Normal Cost	\$1,290,126	\$1,022,860	267,266
01/01/95 Amortization Payment	313,535	229,504	84,031
01/01/95 CAS Pension Cost	1,603,661	1,252,364	351,297
01/01/95 Prepayment Credit	(915,052)	(915,052)	0
Interest to 12/31/95	58,532	28,672	29,860
12/31/95 CAS Funding Target	747,141	365,984	381,157
Contribution	(2,552,700)	(2,171,750)	(380,950)
Interest to 12/3/95	(1,389)	(1,182)	(207)
12/31/95 Unfunded Pension Cost	\$(1,806,948)	\$(1,806,948)	\$0

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STATEMENT OF CAS PENSION COSTS AND FUNDING

APRIL 1, 1986 TO JANUARY 1, 1996

FOOTNOTES

- 1/ We obtained the total company normal cost from Mississippi's actuarial valuation reports. We obtained normal cost for the Medicare segment from data files provided by Mississippi's actuary. The amount shown for the "other segment" represents the difference between the total company and the Medicare segment.
- 2/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Mississippi's valuation reports and IRS Form 5500 reports. The amortization payment was negative for years in which pension assets exceeded actuarial liabilities, thereby creating a negative unfunded actuarial liability.
- 3/ The CAS pension cost represents the sum of the amortization payment and the normal cost. We allocated the CAS pension cost to the Medicare segment based on the ratio of the Medicare segment's payroll to total company payroll for years 1986 and 1987. We separately calculated CAS pension costs for years 1988 through 1995.
- 4/ We applied one year's interest at the assumed rate of 8.0 percent for years 1987 through 1994 and 8.5 percent for 1995 to the CAS pension cost. We obtained the interest rates from the actuarial valuation reports.
- 5/ The annual CAS pension cost, adjusted with interest to the end of the year, must be funded by current and prepaid contributions to satisfy the allowability criteria of FAR, section 31.205-6(j).
- 6/ Mississippi did not make contributions to its pension plan for years 1987 through 1991. However, it did make contributions to the pension plan for years 1986 and 1992 through 1995. For 1986 we assigned contributions to the Medicare segment based on the ratio of the Medicare segment's payroll to the total company payroll. For 1992 through 1995 we assigned contributions to the Medicare segment based on a ratio of Medicare segment's CAS funding target to the total company CAS funding target.
- 7/ We calculated interest on the contributions, from the date of deposit to the end of the year, at the assumed rates of interest (see footnote 4/).
- 8/ The unfunded pension cost represents the CAS funding target less the value of contributions. A prepayment credit is created for years in which contributions are made in excess of the CAS funding target. The prepayment credit is carried forward and applied towards the funding of future CAS pension costs.

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STATEMENT OF CAS PENSION COSTS AND FUNDING
APRIL 1, 1986 TO JANUARY 1, 1996

- 9/ We applied the prepayment credit towards the funding of the CAS pension costs. The prepayment credit is reimbursable for the plan year in which it is absorbed.



John H. Proctor, III
Vice President
Legal & Internal Audit

August 13, 1997

Ms. Barbara A. Bennett
Regional Inspector General For Audit Services
Office of Inspector General, Region VII
601 East 12th Street Room 284A
Kansas City, Missouri 64106

Dear Ms. Bennett:

This letter is to serve as our formal response to the three draft reports received on June 13, 1997 that comprised the *Review of Pension Costs Claimed for Medicare Reimbursement by Blue Cross and Blue Shield of Mississippi*. Based on our previous conversations and subsequent request for an extension, our due date to respond to the draft reports is August 13, 1997.

In our efforts to evaluate the findings and recommendations from the three draft reports, we coordinated our review with our actuary through 1994, Mr. David Donald, as well as our current actuary, Mr. Carl Voss. During the subsequent reviews of the draft reports, we noted several issues and concerns that we will address in our formal response. Listed below under the titles of each of the three draft reports are our Plan's formal responses to your findings and recommendations:

Review of Pension Costs Claimed by Blue Cross and Blue Shield of Mississippi CIN: A-07-97-01211

OIG Finding

From plan years 1988 through 1996, Blue Cross and Blue Shield of Mississippi claimed \$377,452 in pension costs that were not allowable for Medicare reimbursement.

OIG Recommendation

Blue Cross and Blue Shield of Mississippi should revise its Final Administrative Cost Proposals (FACP) to eliminate the unallowable pension costs.

Plan Response

1. Based on previous inquiries and conversations, we found an additional 9 eligible Medicare employees that were not factored into the original Medicare segment for the 1996 fiscal year. The inclusion of these employees in the Medicare segment calculation resulted in a reduction of the nonallowable amount by \$66,452.

2. Per review of the 1996 CAS Valuation Report provided to us with the draft reports, we noted a significant mathematical discrepancy between the 1995 and 1996 Net Amortization calculations. Based on our review, the signs (positive and negative) for the 1996 calculation were exactly opposite of the same amortization used in the 1995 calculation. Therefore, instead of reducing the 1996 Gross Normal Cost by \$666,858 in amortized costs, the proper CAS Pension cost calculation should have added the \$666,858 in net amortized costs. We understand that the net effect of reflecting the audit findings will result in a reduction of the administrative costs for FY 1988 through FY 1996 of \$134,312.
3. During our initial stages of reviewing the OIG draft reports, we were made aware of prepayment credits for the first time. Based on our understanding of the information provided, these new CAS regulations took effect in 1996. It is our general understanding that a prepayment credit exists when amounts that have been funded (contributed) exceed the CAS pension costs.

Correspondence from Mr. Voss indicated that the transition provision of the new CAS regulation provided for an "equitable" transition. The Health Care Financing Administration (HCFA) apparently chose to apply the new rules retroactively. Based on our review of the CAS pension cost calculations, the prepayment credits were calculated retroactively dating back to 1993, however, the credits were reflected in their entirety in the 1996 calculation of the CAS pension costs.

We would like to formally state that we do not deem the retroactive application of the regulation to be an "equitable" transition, nor do we believe that reflecting the retroactive adjustments in one year is an acceptable application. The retroactive application of the new CAS regulations did not allow the Plan the opportunity to account for the calculation of the prepayment credits when claiming pension costs for the years from 1993 through 1996. Also, we believe the regulations should allow for some type of amortization of the prepayment credits rather than the realization of the entire amount in one fiscal year.

Review of Medicare Contractor's Pension Segmentation

CIN: A-07-97-01209

OIG Finding

From plan years 1988 through 1996, Blue Cross and Blue Shield of Mississippi overstated Medicare segment assets by \$816,524.

OIG Recommendation

Blue Cross and Blue Shield of Mississippi should decrease the January 1, 1996 assets of the Medicare segment by \$816,524. The Plan should also separately compute pension costs for the Medicare segment whenever material differences exist between allocated and separately computed CAS pension costs.

Plan Response

Mr. Voss indicated that the calculations that comprised the overall recommendation were proper. We agree with the findings. Mr. Voss indicated that he would make the appropriate adjustments to ensure the OIG recommendations were properly followed. We also agree to begin transferring assets and liabilities from the segment when a Medicare employee retires and takes an annuity payment or terminates employment and is eligible for deferred vested benefits.

**Review of Unfunded Pension Costs of Blue Cross and Blue Shield of
Mississippi
CIN: A-07-97-01210**

OIG Finding

Since Blue Cross and Blue Shield of Mississippi did not make any contributions to the pension trust fund from 1987 through 1991, the plan did not fund the pension costs identifiable with the Medicare segment. Therefore, the plan accumulated \$482,549 in unfunded pension costs.

OIG Recommendation

Blue Cross and Blue Shield of Mississippi should identify and eliminate \$482,549 in unfunded pension costs from the amortization component of future pension costs.

Plan Response

Based on our inquiry with Mr. Voss, we agree with the calculation. Mr. Voss indicated that he would factor in interest and amortize the balance over the next ten years in order to possibly factor those costs into future CAS cost calculations.

We would like to thank you for your timeliness and efforts to assist us in our questions and concerns while attempting to settle this audit engagement. Should you have any questions or need any further assistance or supporting documentation, please feel free to contact myself at (601) 664-4475, or Bryan Lagg at (601) 664-4673.

Sincerely,



John H. Proctor, III

Vice President, Legal and Internal Audit

cc: Jenenne Tambke, Office of Audit Services (OIG)
Carl Voss, External Actuary (Current)
David Donald, External Actuary (Past)
Dorothy Calhoun, Blue Cross Association